Capital

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This paper discusses the application of microeconomic principle to the capital market. Capital markets are regulated primarily for capacity utilization. The traditional approach relates the cost of capital with currency - also known as the Fisher effect. The willingness to borrow and savings are assumed to be linear and capital is subject to depreciation 'δ'. Savings at zero depreciation are taken as arbitrary and positive. The equilibrium represents the amount of borrowed capital and the cost of capital 'i' given by the equation:

$i = \frac{\delta + r}{2}$; wherein 'r' is the internal rate of return of the marginal production unit.

Maximum rates of return and depreciation allow full capacity.

'i' versus 'δ' data for 78 sets (Graph 1) yields a correlation co-efficient 'k' = 0.78. The linear estimation plot derived can estimate the equilibrium cost of capital for any prevailing depreciation rate (Table 1). This may serve as a better tool than regulation.

Graph 1.

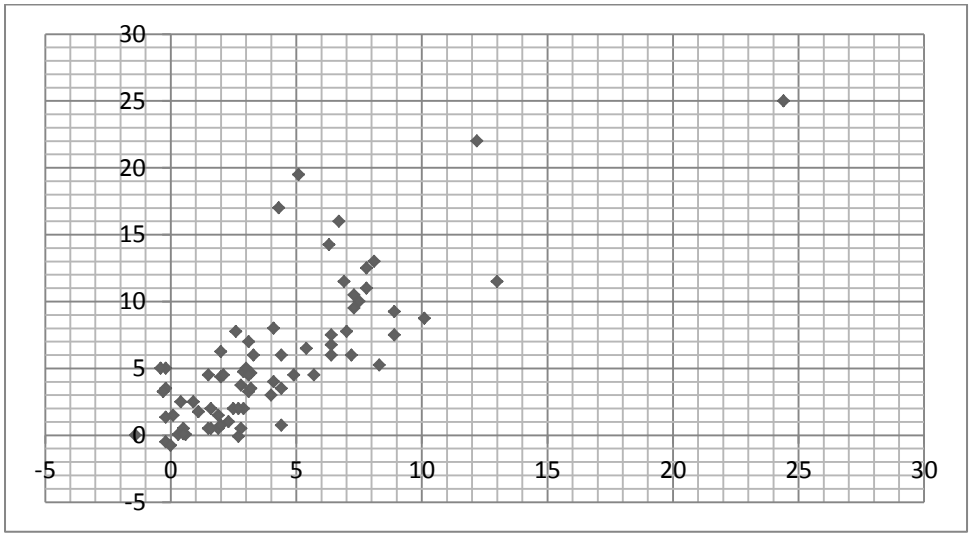

Table 1.

δ	i
1	2.376
2	3.457
3	4.501
4	5.585
5	6.619
6	7.722
7	8.797
8	9.852
9	10.751
10	11.794